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Volume Title: Rational Expectations and Economic Policy

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Volume Publisher: University of Chicago Press

Volume ISBN: 0-226-25134-9

Volume URL: <http://www.nber.org/books/fisc80-1>

Publication Date: 1980

Chapter Title: Introduction to "Rational Expectations and Economic Policy"

Chapter Author: Stanley Fischer

Chapter URL: <http://www.nber.org/chapters/c6258>

Chapter pages in book: (p. 1 - 3)

Introduction

Stanley Fischer

The papers and discussions contained in this volume were presented at a conference on rational expectations and economic policy sponsored by the National Bureau of Economic Research and held at Bald Peak Colony Club, New Hampshire, in October 1978. Developments in the theory of economic policy associated with rational expectations have aroused considerable professional and public interest in the last few years, and it seemed desirable to bring together a group of economists and policymakers to summarize and discuss these developments and, if possible, to focus on outstanding unresolved issues.

Herschel Grossman's introductory chapter surveys and explains developments in economic theory that underlie most of the remaining papers in the volume and briefly outlines the contents of those papers. There would be no point in providing a second introduction, but it should be useful to explain the rationale for the choice of papers for the conference and then to summarize the issues that surfaced in the discussion.

The paper by Robert Barro and Mark Rush summarizes and extends Barro's earlier work on the effects of unanticipated changes in money on output and prices. Barro had moved empirical work on rational expectations to a point where it was clearly understood by many economists and provided apparently strong support for the view that anticipated monetary policy has no real effects. Since the earlier work used annual data, the results needed to be checked against quarterly data: that is what the present paper does.

The Barro and Rush paper presents reduced form evidence that unanticipated money has real effects. The precise mechanism through which changes in unanticipated money affect the real economy deserves careful study: this is the topic generally known as the "monetary

mechanism.” The paper by Olivier Blanchard explores the monetary mechanism, paying particular attention to the differences in impact of anticipated and unanticipated money on the economy. In order to do this, Blanchard had to face the challenge of building an econometric model whose structure would remain approximately invariant to changes in economic policies.

The paper by Robert Shiller is designed to focus on a key point in most theories of the effects of monetary policy on the economy, namely, its impact on real interest rates. In some theories, anticipated changes in the money stock affect real output. According to these theories, anticipated changes in money typically affect the expected rate of inflation and thus the expected real interest rate, which in turn affects inventory or fixed capital accumulation and/or labor supply. Other theories predict that unanticipated changes in the money stock will affect real interest rates and thus the intertemporal allocation of leisure—individuals work more when real interest rates are high and save to have more leisure later. In either case, the impact of money on the real interest rate is crucial. Since the real interest rate that is relevant to economic decisions is the *expected* real rate, which is not observable, it is no simple matter to examine the effects of monetary changes on real rates.

Most of the discussion of economic policy associated with the rational expectations literature has centered on monetary policy. The strong position that anticipated monetary policy could have no real effects has occasionally been transferred to fiscal policy. However, it is clear that changes in tax rates are likely to have real effects and that anticipated fiscal policy stands on a footing very different from that of anticipated monetary policy. For instance, no one would doubt that a preannounced temporary change in the investment tax credit could affect the rate of investment, though many would doubt that a preannounced temporary change in the growth rate of money would have real effects. The proposition that fiscal policy has real effects does not, however, mean that it should be used to mitigate the trade cycle. The Kydland and Prescott paper was invited to discuss optimal fiscal policies in the light of the nonneutralities associated with tax and expenditure changes.

My paper was in part supposed to serve a similar purpose with regard to nonneutralities of anticipated changes in money. A variety of mechanisms through which anticipated changes in money might have both long- and short-term effects on the economy have been studied, and the paper is intended to summarize and evaluate these nonneutralities as the possible basis for activist monetary policy.

The papers by Robert Lucas, Robert Solow, and William Poole were originally to be presented in a discussion of what policy should have

been in 1973–75. The purpose of this session was to concentrate attention on the different policy prescriptions that might be made depending on acceptance or rejection of the rational expectations approach to policy. Robert Lucas argued that the question was not meaningful and wrote a paper on the proposal that monetary growth be kept constant. The three papers taken together do point very clearly to differences of opinion on the role of monetary and fiscal policy that reasonable economists still have.

The major unresolved issue that emerged in the discussion of the papers was that of the clearing or nonclearing of markets. Several participants observed that differences between the authors were a result of their views on whether markets are continuously in equilibrium rather than their views on rational expectations. The only paper that developed a non-market-clearing analysis formally is that by Solow; the question of how one would distinguish empirically between the clearing and nonclearing of markets could usefully have been discussed (Robert Gordon's comment on the Barro and Rush paper addresses that important question), especially given a tendency by proponents of the market-clearing approach to develop analyses of apparent nonclearing phenomena in terms of unobserved market-clearing prices. The associated issue of the rationale for the stickiness of prices received some attention and will continue to receive further attention.

A second unresolved issue concerned the mechanism underlying the Lucas supply function, which suggests that the intertemporal substitution of leisure plays a major role in the propagation of the trade cycle. It would have been useful to have had a paper examining the evidence for the view that there is a substantial short-run elasticity of labor supply in response to transitory changes in real wages or interest rates.

A third unresolved issue, which did not receive much attention, concerns the evaluation of past policy. It is frequently asserted that recent monetary policy has been very poor, but there has been little documentation of this—and the view that econometric policy evaluation is difficult presents some obstacles to making such an appraisal. Nonetheless, the argument that some particular policy rule would be better than current types of policy requires serious appraisal of alternative policies that might have been followed in the past.

The papers themselves leave many other important issues unresolved. But it would not be fair to rob the reader of the opportunity for discovering those issues for her or himself.